No. 22065

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

McKee & Co., a partnership,

Plaintiff and Appellant,

vs.

First National Bank of San Diego, a National Banking Association,

Defendant and Appellee.

On Appeal From the United States District Court for the Southern District of the State of California.

APPELLANT'S OPENING BRIEF.

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Jurisdictional Statement.

This is an appeal from a summary judgment in favor of defendant First National Bank of San Diego (appellee herein), entered on April 6, 1967 by the United States District Court for the Southern District of California [R. 266-267.] On January 12, 1967, plaintiff and appellant herein, McKee & Co., a partnership brought this action for injunctive relief and for damages as an action arising under the National Bank Act, Title 12 U.S.C. §§24.61 and 72 [R. 2-12, 132-134.] A supplemental and amended com-

plaint was lodged February 16, 1967 and was deemed filed by the District Court and appellee for the purposes of the motion for summary judgment [R. 132-134, 154, 169]. The District Court's juridiction was invoked under 28 U.S.C. §1311 [R. 2]. Appellant filed in this Court a timely application for appeal under 28 U.S.C. §1291, and this Court's jurisdiction rests upon that section [R. 208].

Statement of the Case.

This is an action brought by appellant McKee & Co., a shareholder of the First National Bank, to test the validity of certain amendments to the bylaws of appellee Bank, particularly as those amendments applied to appellant. The bylaw amendments are challenged as being contrary to provisions of the National Bank Act, Title 12 U.S.C. §§ 24, 61 and 72, and the general law of the State of California [R. 2-10, 132-134].

The Facts of the Case.

As this is an appeal from a summary judgment and the Court below held that appellant was not entitled to relief as a matter of law, for the purposes of this appeal all of the facts raised in appellant's affidavits must be deemed true. Accordingly the facts are set forth in some detail.

At the time the complaint herein was filed, appellant McKee & Co., owned 84,670 shares of the common stock of appellee Bank, which had a fair market value of approximately $2,500,000 [R. 35-36].

These shares had been acquired, by purchase in the open market, at various times from 1964 through 1966. By December 9, 1966, McKee & Co., had acquired al-

most exactly 100,000 of the 1,056,000 outstanding shares of the Bank [R. 72].

The federal statutes specifically require that the Board of Directors of a National Bank consist of a minimum of five members and that it be elected by "cumulative voting" (12 U.S.C.A. §61). In December, 1966, the by-laws of defendant Bank provided for 21 Directors. As McKee & Co. owned about 10% of the outstanding stock, it would be able to elect two Directors. In late November or December, 1966, the general partner of the plaintiff, Donald McKee, requested Claude Blakemore, the President of defendant Bank, to include two nominees of McKee & Co. on the management slate for election to the Board [R. 137, p. 11-16].

In mid-December, 1966, Mr. McKee and Mr. Blakemore met in Los Angeles. At that time Mr. McKee requested Mr. Blakemore to include Bradbury Clark and William Tooley on the management slate for election to the Board [R. 37]. Mr. Clark was born and educated in San Diego, and now practices law with the firm of O'Melveny and Myers, in Los Angeles. He resides in Los Angeles County, but has extensive business dealings in San Diego County [R. 144, line 21 to 145]. Mr. Tooley was a resident of San Diego from 1956 through 1963, and since that time has maintained extensive business contacts in the San Diego County [R. 139-140]. In 1966 he was a resident of Arizona.

Mr. Blakemore informed Mr. McKee that the Executive Committee of the Bank had voted to invite the nomination of only one man. He suggested that Mr. McKee nominate someone other than Mr. Clark or Mr. Tooley. The man he named was not a resident of San Diego County [R. 36, lines 16-25; R. 137, lines 17-29].

In late December of 1966, Mr. McKee informed Mr. Blakemore that McKee & Co. was entitled to place the names of Mr. Clark and Mr. Tooley in nomination for election to the Board of Directors, and it intended to do so [R. 37, lines 26-30]. By that time, the records of defendants Bank had been "closed", in the sense that pursuant to a resolution of the Board, only shareholders of record early in December, were entitled to vote for members of the Board of Directors.

On January 4, 1967, the Board of Directors of appellee Bank met and unanimously adopted certain amendments to the Bank's bylaws, which amendments are set forth in length in Appendix A.

It is alleged in the Complaint that the sole motive of the Board of Directors, in holding this special meeting, and amending the By-laws, was to prevent McKee and Co. from electing anyone to the Board (Complaint, paras. V to XIV).

Briefly, the amendments added additional provisions to Section 1.3 of the bylaws which required nominations for the appellee's Board of Directors to be delivered to the president of the Bank not less than 14 days prior to any meeting called for the purpose of electing directors, and further required detailed information about each nominee, such as whether the nominee was an attorney, whether he had been involved in any proxy contest in the last 10 years, the amount of stock held by the nominee or members of his family, when such shares were acquired, the nature and extent of any agreements that the nominee might have with others concerning the stock he held, whether such agreements were with other Banks, and, if so, whether the nominee had an agreement regarding future employment with such other banks, the

total amount of shares that would be voted for the nominee, and the amounts of stock, if any, owned by the nominee in other Banks doing business in California. At this special meeting, the Board also adopted a resolution, providing that the Board should have 19, rather than 21, members.

The amendments also added a new Section 2.8 to the bylaws of appellee Bank which dealt with the qualifications of members of the Board of Directors. No one could be a member of the Bank's Board who had not been a resident of a County in which the Bank maintained a banking office for at least one year prior to his election. Appellee knew Tooley was a resident of Arizona. Nor could anyone be a member of the Board who was an attorney of any other banking corporation engaged in business in California. Appellee also knew that Clark was a resident of Los Angeles County, and was a partner in a law firm that had partners who represented Banking Corporations [R. 137, 164].

The Bank did not notify McKee & Co. or any other shareholder of the proposal to amend its by-laws, nor did it serve McKee & Co., or any other shareholder, with a copy of the amendment. The proxy material, mailed about January 4, 1967, contained a writing indicating that the by-laws relating to nomination and qualifications for directors had changed and that any person interested therein should contact the bank. On January 6, 1967, a copy of the amendments were read to an attorney for McKee & Co. and on January 10, 1967, a written copy of the amended by-laws were delivered to an attorney for McKee & Company [R. 36, line 31, to R. 37, line 9]. As the annual meeting of the share-

holders had been set for January 25, 1967, notice of any nomination of McKee & Co. for the Board of Directors had to be delivered to the President of the Bank, and to the Comptroller of the Currency, not later than January 11, 1967 [R. 21-22]. In the time available, between January 5th to January 10th, McKee & Co. attempted to find a resident of San Diego County who was *qualified,* under the by-laws, to serve on the Board of Directors, and who would consent to being nominated to that position. It was unable to do so. Accordingly, on January 10, 1967, McKee & Co., plaintiff herein, served notice of their intention to nominate Mr. Clark and Mr. Tooley, to the Board.

Appellant filed this action on January 13, 1967 and sought a preliminary injunction, to enjoin appellee from refusing to accept the names of Tooley and Clark as nominees and from holding the scheduled elections for the Board of Directors while the questioned amendments were still in effect [R. 48-49]. This application was denied on January 25, 1967, and appellee proceeded to hold its annual meeting on that day [R. 95].

At the meeting, the Bank's president advised the stockholders present that the nominees presented by appellant were ineligible by virtue of the provisions of the recent amendments to the bylaws. He stated that in conversations with Mr. McKee he had learned that the latter intended to nominate certain persons, and it was felt by the Bank that those persons were not local and that their potential loyalty to appellee Bank was open to question; that the appellee Bank had encouraged and built up business over the past 80 years on the philosophy that it was wholly directed and managed locally, that much money had been spent to create the

image that the Bank was wholly local.[1] He continued that for these reasons the Bank had amended its bylaws so as to formulate a long standing policy of having only local persons on the Board, known to be loyal to the Bank [R. 163-165].

Notwithstanding the fact that Clark and Tooley were declared ineligible, each received slightly in excess of 1,000,000 votes, more than enough to elect them. The nominees on the management slate received 781,000 or more votes [R. 133, 199].

On February 3, 1967, appellee Bank filed a motion for summary judgment, which motion was granted, and judgment entered thereon on April 6, 1967 [R. 206-207]. In its Findings of Fact and Conclusions of Law [R. 196-200], among other things, the District Judge found that appellant's nominations were in conformance with bylaw 1.3, as amended, that the amendment to bylaw Section 2.8 was with the intention and for the purpose of rendering ineligible the nominees of appellant, and that appellee knew that although said amendment appeared innocuous on its face, as a practical matter, at least for the election of January 25, 1967, its practical effect was to exclude Clark and Tooley [R. 199, Find. 20]. The District Judge concluded that even assuming the appellant's showing with respect to appellee Bank's motive and purpose in adopting the bylaw was true, such motive and intent was not a matter of judicial inquiry, and that appellant's alle-

[1]On April 19, 1967, appellee BANK announced that it was acquiring, subject to shareholder approval, the Saddleback National Bank of Tustin, California, the Huntington-Valley Bank of Huntington Beach, California, and on June 22, 1967 made a similar anouncement with respect to its intended acquisition of the Heritage-Wilshire Bank of Los Angeles, California (Records of the Comptroller of Currency).

gations with respect thereto were irrelevant. The Court stated, in the Findings: "For the purpose of the motion for summary judgment, the court assumes as true the plaintiff's showing as to interest and purpose in amending the By-laws" [Finding 20, R. 199]. It concluded that therefore the bylaws as amended were reasonable as at matter of law and were reasonably applied to appellant's nominees without discrimination; that *appellant* had never sought a waiver of the new provisions of the bylaws, and that there was no genuine issue as to any material fact [R. 200].

Specifications of Errors Relied Upon.

1. The District Court erred in holding that appellee Bank's motives and intent in adoption of the amendments to the bylaws were irrelevant.

2. The District Court erred in holding that the amendments to the bylaws were reasonably applied to appellant and its nominees without discrimination.

3. The District Court erred in holding that the amendments to the bylaws were reasonable as a matter of law.

4. The District Court erred in holding that there were no genuine issues of material fact.

5. The District Court erred in concluding that the appellant was entitled to no relief.

Questions Presented.

1. Is the question of whether a particular bylaw is reasonable or not, always a question of law?

2. May a National Banking Corporation enact bylaws which have as their motive and purpose, the exclusion of certain known persons from the Board of

Directors, which persons are the nominees of a minority stockholder and would otherwise have been elected?

3. Does the Board of Directors of a National Banking Corporation owe a fiduciary duty to a minority stockholder?

4. May the Board of Directors of a National Banking Corporation enact a bylaw to intentionally nullify a minority stockholder's cumulative voting power?

Statutes Involved.

1. 12 U.S.C. §24. CORPORATE POWERS OF ASSOCIATIONS.

> "Upon duly making and filing articles of association and an organization certificate that [a national banking] association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power—"
>
> * * *
>
> "SIXTH. To prescribe by its board of directors, by-laws not inconsistent with law, regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers, appointed, its property transferred, its general business conducted, and the privileges granted to it by law exercised and enjoyed."
>
> * * *

2. 12 U.S.C. §61. RIGHT OF SHAREHOLDERS TO VOTE HOLDING COMPANY AFFILIATES—VOTING PERMITS.—

> "In all elections of directors, each shareholder shall have the right to vote the number of shares

owned by him for as many persons as there are directors to be elected, or to cumulate such shares and give one candidate as many votes as the number of directors multiplied by the number of his shares shall equal, or to distribute them on the same principle among as many candidates as he shall think fit; and in deciding all other questions at meetings of shareholders, each shareholder shall be entitled to one vote on each share of stock held by him; except that (1) this shall not be construed as limiting the voting rights of holders of preferred stock under the terms and provisions of articles of association, or amendments thereto, adopted pursuant to the provisions of section 302-(a) of the Emergency Banking and Bank Conservation Act, approved March 9, 1933, as amended [§51b(a) of this title], (2) in the election of directors, shares of its own stock held by a national bank as sole trustee, whether registered in its own name as such trustee or in the name of its nominee, shall not be voted by the registered owner unless under the terms of the trust the manner in which such shares shall be voted may be determined by a donor or beneficiary of the trust and unless such donor or beneficiary actually directs how such shares shall be voted, (3) shares of its own stock held by a national bank and one or more persons as trustees may be voted by such other person or persons, as trustees, in the same manner as if he or they were the sole trustee, and (4) shares controlled by any holding company affiliate of a national bank shall not be voted unless such holding company affiliate shall have first ob-

tained a voting permit as hereinafter provided, which permit is in force at the time such shares are voted, but such holding company affiliate may, without obtaining such permit, vote in favor of placing the association in voluntary liquidation or taking any other action pertaining to the voluntary liquidation of such association. Shareholders may vote by proxies duly authorized in writing; but no officer, clerk, teller, or bookkeeper of such bank shall act as proxy; and no shareholder whose liability is past due and unpaid shall be allowed to vote. Whenever shares of stock cannot be voted by reason of being held by the bank as sole trustee, such shares shall be excluded in determining whether matters voted upon by the shareholders were adopted by the requisite percentage of shares.

For the purposes of this section shares shall be deemed to be controlled by a holding company affiliate if they are owned or controlled directly or indirectly by such holding company affiliate, or held by any trustee for the benefit of the shareholders or members thereof.

Any such holding company affiliate may make application to the Board of Governors of the Federal Reserve System for a voting permit entitling it to vote the stock controlled by it at any or all meetings of shareholders of such bank or authorizing the trustee or trustees holding the stock for its benefit or for the benefit of its shareholders so to vote the same. The Federal Reserve Board [Board of Governors of the Federal Reserve System] may, in its discretion, grant or with-

hold such permit as the public interest may require. In acting upon such application, the Board shall consider the financial condition of the applicant, the general character of its managements, and the probable effect of the granting of such permit upon the affairs of such bank, but no such permit shall be granted upon the following conditions:"

* * *

3. 12 U.S.C. §72. QUALIFICATIONS.—

"Every director must during his whole term of service, be a citizen of the United States, and at least two-thirds of the directors must have resided in the State, Territory, or District in which the association is located, or within one hundred miles of the location of the office of the association, for at least one year immediately preceding their election, and must be residents of such State or within a one-hundred-mile territory of the location of the association during their continuance in office. Every director must own in his own right shares of the capital stock of the association of which he is a director the aggregate par value of which shall not be less than $1,000, unless the capital of the bank shall not exceed $25,000 in which case he must own in his right shares of such capital stock the aggregate par value of which shall not be less than $500. Any director who ceases to be the owner of the required number of shares of the stock, or who becomes in any other manner disqualified, shall thereby vacate his place."

Summary of Argument.

The members of the Board of Directors of a National Bank stand in a fiduciary relationship to the Bank and to the minority shareholders thereof. Under the terms of the summary judgment and the Findings and Conclusions upon which it was based, appellee National Bank was permitted to amend its bylaws with the motive and specific purpose of preventing appellant, a minority stockholder from nominating and electing certain persons to the Bank's Board of Directors. The bylaws in question admittedly were enacted for just that reason, though carefully drafted to appear valid upon their face. It is respectfully submitted that when evidence of such improper motive and practical discriminatory effect is placed before the Court, a genuine issue concerning a material fact has been presented and a Court may not, as a matter of law, find that such bylaws are reasonable and therefore valid.

ARGUMENT.

I.

A Motion for Summary Judgment Should Not Be Granted Where There Is a Genuine Issue as to a Material Fact.

While a motion for summary judgment provides a means of disposing of sham cases, it will not be granted when there is a genuine fact issue. *Stevens v. Howard D. Johnson Co.,* (4th Cir., 1950) 81 F. 2d 390; *McHenry v. Ford Motor Co.,* (6th Cir., 1959) 269 F. 2d 18.

Further, it has frequently been held that the motion is looked upon with disfavor. *United Meat Co. v. R.F.C.,* (1949) 174 F. 2d 528, 85 U.S. App. D. C. 9.

Likewise, it has been said that a litigant has a right to a trial where there is the slightest doubt as to the facts. *Peckham v. Ronrico Corp.,* (1st Cir. 1948) 171 F. 2d 653, 657.

It is submitted that in the case at bar, the Court erred in granting a summary judgment because the parties were entitled to a trial on the important issues of fact.

II.

The Bylaws of Appellee Bank May Be Found to Be Unreasonable if the Motive and Purpose of the Board of Directors in Adopting Them Was to Render Ineligible Known Nominees to the Board Submitted by a Minority Stockholder.

The National Banking Act, 12 U.S.C. §24, provides that a National Banking Association may, through its Board of Directors adopt bylaws not inconsistent with the law. The law referred to is that set forth in

other relevant Federal statutes, decisions of Federal Courts, and to all of the laws of the State, in so far as they do not conflict with Federal law. *Anderson National Bank v. Luckett,* (1944) 321 U.S. 233. 64 S. Ct. 599, 88 L. ed. 692. Both the Federal Courts and the California Courts have unequivocally stated that corporate bylaws must not only be reasonable in themselves, but also reasonable in their application. *Selama-Dindings Plantations, Ltd. v. Durham,* (D.C. Ohio 1963) 216 F. Supp. 104, 115; Affirmed (6th Cir. 1964) 337 F. 2d 949; *People's Home Savings Bank v. Superior Court of the City and County of San Francisco,* 104 Cal. 649, 652; 38 Pac. 452 (1894).

In *Selama-Dindings Plantations, Ltd. v. Durham,* the validity of two corporate bylaws was considered by the Court. One prohibited the stenographic recordation of the proceedings of the Board of Directors and the other provided for an executive committee from which minority directors were excluded. After a trial on the merits, the Court concluded that although the questioned bylaws were reasonable and therefore valid,

> "It is a general essential of their validity that bylaws shall be reasonable and not arbitrary or oppressive. Amendments and new bylaws, equally with those adopted in the beginning, must meet these general requirements. And bylaws must not only be reasonable themselves, but must not be unreasonable in their practical application." 216 F. Supp. at p. 115.

The validity of a bylaw of a bank dealing with the manner in which a proxy could be voted was considered in *People's Home Savings Bank v. Superior Court,*

supra. In declaring that the by-laws were in conflict with the law of the State of California, the Court said,

> ". . . Corporations have no power to create by-laws that are unreasonable in their practical application, or that are violative of the statute of the state; . . ." 104 Cal. at p. 652.

The judgment of the trial Court in the instant case can stand only if, as a matter of law, the bylaws in question are valid, that is, reasonable within the definitions given to that term by the Federal and California Courts. It is submitted that the Courts of both jurisdictions, as well as the learned writers on the question have concluded that whether a bylaw is reasonable or not invariably depends upon the facts and circumstances of each individual case. An examination of the cases relied upon by the District Court for the proposition that the reasonableness of bylaws is a matter of law, discloses an absence of relationship between the passage of the questioned bylaw and its application to the complaining shareholder or other party.

Thus in *Tu-Vu Drive-In Corp. v. Ashkins,* 61 Cal. 2d 283, 391 P. 2d 828 (1964), an amendment to the bylaws of a closely held corporation provided that shares of stock must first be offered for sale to the other stockholders before they could be sold to an outsider. The amendment was adopted on June 24, 1960, and was amended on June 23, 1961. Its legal and practical effect was the same as to all stockholders. No facts appear from the record that the bylaw was passed

for the principal purpose of affecting or limiting his rights, nor does the record disclose that the complaining stockholder was personally prejudiced in any way. There was no evidence in the record that the remaining stockholders would have paid less for Ashkin's shares than she could have obtained on the open market. However, the Court in *Tu-Vu* went on to point out that in other cases a "right of first refusal" by law might be invalid where all the other facts and circumstances of each case were considered. *Tu-Vu Drive-In, supra,* 61 Cal. 2d at p. 286, footnote 3. Further, it is vital to note that *Tu-Vu Drive-In Corporation* was closely held by only three stockholders where business motives might justify a bylaw which would be unreasonable for a publicly owned banking corporation such as appellee herein.

The Court below also placed heavy reliance on *People v. Ittner,* 165 Ill. App. 360 (1911). The facts of that case disclose that the corporation had a bylaw that a director (or any member of his family) could not be directly or indirectly interested as a stockholder in a like firm or association. Two persons, otherwise elected, were excluded from the Board as a result of this bylaw. On a Writ of *quo warranto,* the Court was asked to hold the bylaw unreasonable as a matter of law. The Appellate Court held that the bylaw was reasonable and reasonably applied to the complaining stockholder. The Court in the *Ittner* case quoted at length from Fletcher, *Cyclopedia Corporations,* as did the Court below. However, neither acknowledged the principal and well docu-

mented proposition set forth in 8 Fletcher, *Cyclopedia Corporations,* §4191, pp. 721-729 (perm. ed. 1966), which states, after reiterating that a bylaw and any amendments thereto must be both reasonable on their face and in their application,

> "It is manifest that reasonableness in its nature is not a matter for determination by any universal test or general rule, and that the reasonableness of any particular bylaw or bylaws *depends almost entirely upon the facts and circumstances of the particular case."* Fletcher, Cyclopedia, at p. 725 (emphasis addded).

As authority for that proposition, the treatise cites *Selama-Dindings, supra,* and the California case of *Bennett v. Hibernia Bank,* 47 Cal. 2d 540, 305 P. 2d 20 (1956).

The *Bennett* case involved a bylaw of a membership banking corporation which provided "No one shall be deemed a member whose account is once closed." The Bank sought to apply it against one who became a member before its adoption. While the bylaw appeared valid on its face, and its adoption grounded in legitimate business motives, the Court held that the reasonableness of the bylaw was not a question of law, but that

> "The reasonableness of the by-law must be considered in the light of all the circumstances, including such matters as the purposes for which the corporation was organized and the extent of the rights of the particular member involved. Hiber-

nia's certificate of incorporation provides that 'the object for which it is formed is that of aggregating the funds and savings of the members of said Corporation and of others, and of preserving and safely investing the same for their common benefit.' It may be that it was considered necessary to require members to retain their accounts and deposits with Hibernia in order to promote the success of the bank in accordance with the purposes for which it was organized. However, these are matters which must be determined by the trier of fact in the light of all of the evidence." 47 Cal. 2d at pp. 552, 553.

From the foregoing authorities it is apparent that the validity and reasonableness of a bylaw depends upon the facts of the individual case. It is also apparent that the reasonableness of a bylaw is to be considered in light of the purposes of the corporation and the correlative purpose of the adoption of the bylaw, together with its practical application and extent of impairment, if any, of the rights of the stockholder. See Fletcher, *Cyclopedia Corporations, Ibid.; Re Rogers Imports, Inc.,* 202 Misc. 761, 116 N.Y.S. 2d 106 (1952); *Mancini v. Patrizi,* 87 Cal. App. 435, 262 Pac. 375 (1927).

The District Court acknowledged the rule set forth in *Yick Wo v. Hopkins,* 118 U.S. 356, 6 S. Ct. 1064, 30 L. Ed. 220 (1886), that a statute or ordinance, although apparently reasonable and constitutional on its face, might nonetheless be unreasonable and unconstitutional when applied discriminatorily to one per-

son or group. *Such application would clearly be a factual determination.* It is therefore surprising that the District Court noted in its opinion granting the summary judgment that

> "There is utterly no showing of any such unreasonable application or threat of application of the bylaws or any such discrimination or threat of discrimination. So far as the record shows, the new bylaws will be applied fairly and reasonably and without discrimination to any party." [R. 190].

It is submitted the record is replete with facts demonstrating that the bylaws were unreasonable and were unreasonably applied to appellant.

We observe, at the outset, that the by-laws distinguish between the procedure required for nominations by management, and those made by persons "other than management." Moreover, the relatively short period of time, between the adoption of the by-laws, and the date for filing notice of nominations is unreasonable, on its face, or at least raises a factual issue as to reasonableness.

In this regard, we observe that on January 4, 1967, the date the Amendments were adopted, Appellant could not have sold or transferred its shares to another party, for nomination or voting on the members of the Board, for the books of the Bank were already "closed", as to the record date for voting at the shareholder's meeting. This in itself, we submit, indicates the Board's action was unreasonable.

Moreover, in thus attempting to *retro-actively* alter a shareholder's right to nominate candidates of its own choice for the Board of Directors, the Board clearly vio-

lated California law. The power to nominate a member of the Board of Directors is one of the most important rights of a shareholder, and we submit that it may not be altered, retrospectively. As stated in *Bornstein v. District Grand Lodge, 2* Cal. App. 6, 24 at 628, if "by giving it a retrospective operation it would have the effect to annul or impair an existing obligation on the part of the corporation, such by-law will be held unreasonable and in contravention of existing laws." Similarly, in *Lindsay-Strathmore Irrigation District v. Wutchumna Water Co.,* 111 Cal. App. 688, 701 the Court stated that by-laws must *operate* equally upon all persons of the same class, and a by-law adopted by the Board of Directors for the sole purpose of excluding the shareholder from enjoyment of the rights represented by stock already acquired was therefore void. (See also 12 Cal. Jur. 2d 660-661).

Application of the new by-laws to disqualify the duly elected nominees of McKee & Co. was also improper because *notice* of the new by-laws was not duly given the shareholders. The regulations of the Comptroller of the Currency specifically provide that "Three preliminary copies of any additional soliciting material, relating to the same meeting or subject matter, furnished to security holders subsequent to the proxy statement shall be filed with the Comptroller at least two days (exclusive of Saturdays, Sundays or holidays) prior to the date copies of such material are first sent or given to security holders, or such shorter period prior to such date as the Comptroller may authorize upon a showing of good cause therefore." (Part II of Title 12, Code of Fed. Reg., as revised in 31 F.R. 6949, May 12, 1966).

The record shows that the appellee Bank did not file the amended by-laws, together with the notice of amendment, with the Comptroller, at least two days prior to the date the proxy material was sent to the shareholders. It follows that as a matter of law, the shareholders, including appellant, did not receive timely notice of the changes in nomination and qualification of directors.

The District Court relied heavily on the fact that appellant did not ask appellee Bank to waive the 14 day notice requirement of bylaw Section 1.3, so that new acceptable nominess could be submitted.

However, the by-laws do not provide for such waiver, and there is absolutely no factual basis, in the record, to support the Court's *presumption* that such waiver could, or would, have been granted [*Cf.* Opinion, R. 791, and Finds. 13 and 14, and Conclusion 5, at R. 198 and 200]. It is the general rule, in California, that a by-law may only be waived by the *unanimous* consent of the shareholders. (*Hymen v. Stein Co.,* 47 Cal. App. 605). In this instance, it was impossible to obtain such consent, prior to the shareholder's meeting. The vote at the meeting, and the attitude of management, shows that *unanimous* consent was not obtainable.

If, as appellant contends, the *motive* of the Directors in amending the by-laws was to exclude appellant's nominee, from the Board, it is evident that such waiver would not have been made by the Bank officers or Directors. It was possible for the Bank officers to waive the residence requirement, and they refused to do so.

The District Court also overlooks the fact that appellant knew the Bank intended a "battle", and that it was

apparent that the amendments were enacted to carry out that threat and to block appellant. The law does not require a useless act. Further, it would be unrealistic to expect appellant, in a short period of less than 2 weeks, to find two substantial persons who had sufficient experience and could devote the time required to the directorship of a growing multi-branch Bank.

By analogy, in other fields of the law, reasonableness is a question of fact. Thus the reasonableness of rate regulations has been held to upon the circumstances of each case. See *Noroton Water Company v. Public Utilities Commission,* 193 A. 2d 724, 24 Conn. Sup. 441 (1962); *Birmingham Electric Co. v. Alabama Public Service Commission,* 47 So. 2d 455, 254 Ala. 140 (1950).

It remains but to inquire whether or not there was a genuine issue on a material issue of fact as shown by the record from below. For the purpose of ruling upon the motion for summary judgment, the Court assumed that the following facts were true, although it is to be noted that appellee Bank disputes said facts [R. 171-172]:

1. There was an intent and purpose on the part of the directors of the defendant-appellee to exclude appellant's nominees from the Board of Directors.

2. There is a lack of any showing that Clark and Tooley, appellant's nominees, would not have been loyal directors.

3. That the executive committee of appellee Bank, prior to the amendment of the bylaws had stated that they would permit appellant to nom-

inate one director, not a resident of San Diego County.

4. That appellee-Bank was then informed that appellant desired to nominate and elect two directors and that appellee's president stated there would be a "battle" would ensue.

5. That in the past directors had served on the Board who were not residents of San Diego County.

6. That appellee-Bank was negotiating toward the acquisition or merger with a Bank or Banks which are located outside of San Diego County.

From the foregoing it is apparent that the reasonableness of appellee's Bank's amendments to its bylaws and the reasonableness of their application to appellant present several questions of fact that must be determined at a trial after both parties have had an opportunity to engage in extensive discovery proceedings. To hold otherwise would be tantamount to ruling that a Bank or corporation could, for example, lawfully adopt a bylaw providing that only persons who had previously served upon the Board of Directors would be eligible for subsequent election thereto. Such a bylaw, which might appear valid on its face, as with those in the case at bar, would effectively deprive a minority stockholder of the rights of cumulative voting accorded to him under 12 U.S.C. §61.

Accordingly, it is respectfully submitted that the District Court was in error in holding that appellee's bylaws were reasonable and valid as a matter of law and that they had been reasonably applied to appellant. The reasonableness of the bylaws and their application presented genuine issues of material facts upon which appellant was and is entitled to a full trial on the merits.

III.

Granting of Summary Judgment Was Prejudicial Error in That There Was a Genuine Issue of Material Fact as to Whether the Bylaws Were so Unreasonable as to Breach the Defendant's Directors Fiduciary Duty to the Corporation and to Minority Shareholders.

As hereinabove set forth, in the case at bar the District Judge found the questioned bylaws reasonable regardless of the motives underlying their formulation [R. 199-200], and therefore, precluded any inquiry into whether or not the directors who enacted these bylaws adhered to their fiduciary duty to the corporation and to minority shareholders. It is respectfully urged that this was prejudicial error, in that there appeared from the pleadings a "genuine issue of material fact" as to whether or not the directors breached their fiduciary duties.

In *Perlman v. Feldman* (2nd Cir. 1954), 219 F. 2d 173, minority stockholders brought a derivative action against Feldman, who was a director and dominant stockholder of the Newport Corporation, for restitution of allegedly illegal gains resulting from the sale of his controlling interest in the corporation. The Court held on appeal that:

> "Both as director and as dominant stockholder, Feldman stood in a fiduciary relationship to the corporation and to the minority stockholders as beneficiaries thereof." (*Perlman, supra,* p. 175).

Thus, in considering the law of the State of incorporation, the Federal Court of Appeals for the Second Circuit, imposed a fiduciary duty on directors which ran to the corporation and to minority shareholders.

See also, *Pepper v. Litton,* 308 U.S. 295, 306, 60 S. Ct. 238, 84 L. ed. 281 (1939), relied upon in *Perlman.*

California law imposes a similar duty upon corporate directors (Cal. Corp. Code §820). In California directors are fiduciaries and must exercise their powers in good faith, and with a view to the interest of the corporation. In *Bancroft-Whitney Co. v. Glen,* 64 Cal. 2d 327, 49 Cal. Rptr. 825 (1966), the California Supreme Court said at page 345:

> "A public policy . . . has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation . . ."

The burden of proof with respect to the reasonableness of a fiduciary's actions is upon the fiduciary. *Rogers v. Hill* (1933), 289 U.S. 582, 53 S. Ct. 731, 77 L. ed. 1385.

In the instant case plaintiff set forth in its counter affidavits that the express purpose of the bylaws now attacked were to exclude the two directors selected by the minority shareholders. It is appellant's contention that if this were true then it constitutes a breach of the dominant stockholder's fiduciary duty to the minority shareholders and the corporation. It indirectly impinges upon the right of minority shareholders to vote their shares cumulatively for the candidate of their choice which right is mandatory in California (Cal. Corp. Code §2235) and under the National Bank Act. 12 U.S.C. §61. By granting summary judgment to the defendants the District Judge ignored the issue of fact

set up in the pleadings, precluded proof on defendant directors' alleged breach of their fiduciary duty, and thereby, it is submitted, committed prejudicial error.

In *D'ippolito v. Cities Service Company,* 374 F. 2d 643 (2nd Cir. 1967) the District Court granted summary judgment against seven plaintiffs and they filed a mandamus action to allow the filing of an amended complaint. The Court of Appeals reversed the District Court's holding that under the allegations of plaintiff's complaint it appeared that some defendants may have acquired unclean hands so as to bring in the doctrine of *Perlman v. Feldman* (*D'ippolito, supra,* p. 648).

In the case at bar the allegations contained in plaintiff's complaint, and the affidavits in opposition to summary judgment raise the inference of "unclean hands" on the part of defendant's directors, and plaintiff should, therefore, be allowed a trial on the merits of his action.

The ruling below is squarely contrary to the law of California, which holds that a corporate by-law is only reasonable when it is adopted in *good faith.* In *Fairchild v. Bank of America,* 192 Cal. App. 2d 252, 256, the Court stated that it would not intermeddle

> "with the internal affairs of a corporation in the absence of *fraudulent conduct* on the part of those who have been lawfully entrusted with the management and conduct of its affairs." (Emphasis added).

In this instance, appellant asserted that the Board did not act in good faith, but amended the by-laws for the sole purpose of excluding appellant's nominee from the Board. Appellant further asserted the Board's ac-

tion was taken to prevent the election of any independent Director, who would have access to the books of the corporation, and power to review the acts of management, and the "closed" Board of Directors. Certainly, the Board action to prevent election of independent Directors would violate every principle of corporate democracy, and exceed the limitations placed upon Directors by federal and state law. The averments in the affidavits filed herein clearly raise material facts that warrant a full judicial hearing.

Conclusion.

It is respectfully submitted that the Court below erred in granting a summary judgment for appellee and that said judgment should be reversed and the case remanded for trial upon the merits.

HERVEY AND MITCHELL,
By THOMAS R. MITCHELL and
CHARLES G. WARNER,
Attorneys for Appellant.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ THOMAS R. MITCHELL

APPENDIX.

Section 1.3. *Nominations for Director.* Nominations for election to the Board of Directors may be made by the Board of Directors or by any stockholder of any outstanding class of capital stock of the Bank entitled to vote for the election of directors. Nominations, other than those made by or on behalf of the existing management of the Bank, shall be made in writing and shall be delivered or mailed to the President of the Bank and to the Comptroller of the Currency, Washington, D. C., not less than fourteen days nor more than fifty days prior to any meeting of stockholders called for the election of directors, provided, however, that if less than twenty-one days' notice of the meeting is given to shareholders, such nomination shall be mailed or delivered to the President of the Bank and to the Comptroller of the Currency not later than the close of business on the seventh day following the day on which the notice of meeting was mailed. Such notification shall contain the following information to the extent known to the notifying shareholder: (a) the name and address of each proposed nominee; (b) the principal occupation of each proposed nominee; (c) the total number of shares of capital stock of the Bank that will be voted for each proposed nominee; (d) the name and residence address of the notifying shareholder; and (e) the number of shares of capital stock of the Bank owned by the notifying shareholder. Nominations not made in accordance herewith may, in his discretion, be disregarded by the Chairman of the meeting, and upon his instructions, the vote tellers may disregard all votes cast for each such nominee.

(Prior to amendment January 4, 1967)

Section 1.3. *Nominations for Director.* Nominations for election to the Board of Directors may be made by the Board of Directors or by any stockholder of any outstanding class of capital stock of the Bank entitled to vote for the election of directors. Nominations, other than those made by or on behalf of the existing management of the Bank, shall be made by notification in writing delivered or mailed to the President of the Bank and to the Comptroller of the Currency, Washington, D. C., not less than fourteen (14) days or more than fifty (50) days prior to any meeting of stockholders called for the election of directors, provided, however, that if less than twenty-one (21) days' notice of the meeting is given to shareholders, such nomination shall be mailed or delivered to the President of the Bank and to the Comptroller of the Currency not later than the close of business on the seventh day following the day on which the notice of meeting was mailed. Such notification shall contain the following information as to each proposed nominee and as to each person, acting alone or in conjunction with one or more other persons, in making such nomination or in organizing, directing or financing such nomination or solicitation of proxies to vote for the nominee: (a) the name, age, residence address, and business address of each proposed nominee and of each such person; (b) the principal occupation or employment, the name, type of business and address of the corporation or other organization in which such employment is carried on of each proposed nominee and of each such person; (c) if the proposed nominee is an attorney, a statement as to whether or not either he or any attorney or firm with whom he has an office relationship as partner, associate, employee, or otherwise, is an attorney for any

banking corporation, affiliate or subsidiary thereof, or bank holding company engaged in business in California; (d) a statement as to each proposed nominee and a statement as to each such person stating whether the nominee or person concerned has been a participant in any proxy contest within the past ten years, and, if so, the statement shall indicate the principals involved, the subject matter of the contest, the outcome thereof, and the relationship of the nominee or person to the principals; (e) the amount of stock of the Bank owned beneficially, directly or indirectly, by each proposed nominee or by members of his family residing with him and the names of the registered owners thereof; (f) the amount of stock of the Bank owned of record but not beneficially by each proposed nominee or by members of his family residing with him and by each such person or by members of his family residing with him and the names of the beneficial owners thereof; (g) if any shares specified in (e) or (f) above were acquired in the last two years, a statement of the dates of acquisition and amounts acquired on each date; (h) a statement showing the extent of any borrowings to purchase shares of the Bank specified in (e) or (f) above acquired within the preceding two years, and if funds were borrowed otherwise than pursuant to a margin account or bank loan in the regular course of business of a bank, the material provisions of such borrowings and the names of the lenders; (i) the details of any contract, arrangement or understanding relating to the securities of the Bank, to which each proposed nominee or to which each such person is a party, such as joint venture or option arrangements, puts or calls, guaranties against loss, or guaranties of profit or arrangements as to the division of losses or profits or with respect to the giving or withholding of proxies,